IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT.

No. 7488.

GALEN H. WELCH, Collector of Internal Revenue for the Sixth Collection District of California,

Appellant,

vs.

THE ST. HELENS PETROLEUM COMPANY, LIMITED, a corporation,

Appellee.

On Appeal from the District Court of the United States for the Southern District of California.

BRIEF SUBMITTED BY WILLIAM H. HOTCHKISS AND JOHN S. BRECKINRIDGE, *AMICI CURIAE.*

WILLIAM H. HOTCHKISS,
JOHN S. BRECKINRIDGE,
Amici Curiae.

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ON APPEAL FROM THE DISTRICT COURT OF THE UNITED STATES FOR THE SOUTHERN DISTRICT OF CALIFORNIA.

BRIEF SUBMITTED BY WILLIAM H. HOTCHKISS AND JOHN S. BRECKINRIDGE, *AMICI CURIAE.*

Statement of the Case.

This *amici curiae* brief is presented pursuant to a stipulation by the parties granting permission therefor.

Our interest in this case is that we represent over thirty British insurance companies who are transacting business in the United States through United States branches duly admitted and licensed under the laws of our various States. Such companies, in computing their Federal income tax liability, have claimed the right to deduct the United Kingdom income tax imposed upon their profits and paid by them to the extent that such tax is imposed upon or connected with their income.

It is our contention that both under British law and under American law the British company, and not its shareholders, is the taxpayer and entitled to the tax deduction and that the British company is not reimbursed for the tax by nor does it recoup such tax from its shareholders.

This brief will be confined to the issue in these proceedings which has to do with the appellee's deduction for British income taxes. The British tax question has assumed a position of importance and prominence since the decision in the Court below. There are now pending before the United States Board of Tax Appeals the appeals of *The London and Lancashire Insurance Company, Ltd.*, Docket Nos. 68556 and 73179, and *The London Guarantee and Accident Company*, Docket No. 73240, and, in addition, several cases involving the British tax credit or deduction allowable to individual shareholders in British companies, viz.: *George W. Elkins*, Docket No. 75742; *Mary Duke Biddle*, Docket No. 62025; *Leslie H. Reed*, Docket No. 75812; *State Planters Bank & Trust Co., Admr., d. b. n. c. t. a., Estate of Marie Cooke Hickey*, Docket No. 75849; and *State Planters Bank & Trust Co., Executor, Estate of James J. Hickey*, Docket No. 75852.

The appellant, in this case, has denied the deduction allowable to the appellee for British income taxes imposed upon and paid by it because the amount of tax "deducted" by the appellee from its dividend distribution to its shareholders, at least, equaled the tax so imposed and paid. This denial was apparently first made by the appellant on the theory advanced in *S. M. 3040,* C. B. IV-1, 198, and *S. M. 5363*, C. B. V-1, 89, that the appellee paid its British income tax as agent for or on behalf of its shareholders. After consideration of the records and voluminous briefs since filed in all the various proceedings involving the British tax question, it has at once become apparent that this theory of agency has been thoroughly exploded and has been abandoned in such proceedings, if not in this. In lieu of this theory, new contentions have been raised to the effect that the shareholders pay the tax; that the company recoups or is reimbursed for the tax, etc. All of these new contentions not only are answerable, but, as the appellee believes, may be wholly refuted.

Further, this British tax question has been surrounded by a dense fog of notions, fictions and excess verbiage. The necessity for finespun theories is hardly conceivable in solving so practical a question as, upon whom is the British tax imposed and by whom is it paid. Hence, this brief has been prepared with the intention and hope of being of some assistance in clearing away the fog.

Summary of Argument.

Under the Federal Revenue Act of 1921, the deduction for taxes (including income taxes paid to a foreign country) is allowable to the one upon whom the taxes were imposed and by whom they were paid.

It has been stipulated that the appellee paid United Kingdom income taxes of $41,657.19 for such fiscal year, of which $41,553.05 was allocable to income from United States sources. Such taxes were paid under the British Income Tax Act, 1918, and the Finance Acts applicable to such years. These taxes were so paid by the company and were so assessed by the British Crown under Rule 1 of the General Rules and Sections 237 and 106 of the Income Tax Act. Such provisions are unambiguous and leave no room for interpretation. They impose a tax on the company as a "body of persons" in like manner as any other person is chargeable. Hence, there was both imposition and payment of these taxes and such imposition was on and such payment was made by the appellee.

Under Rule 20 of the General Rules, Income Tax Act, 1918, a British company is also charged with the tax on its profits but may, if it chooses, in distributing a dividend to shareholders, deduct the tax appropriate thereto. It has therefore been asserted that, under the operation of such rule, the shareholder and not the company is the taxpayer to the extent that a tax is "deducted" from dividends, or that in any event the company has recouped itself or has been reimbursed for the tax. In support of this assertion, various arguments and theories have been advanced which are contrary to the express provisions of the statute, the opinions in the British cases and the actual facts as to imposition and payment.

Agency: The theory was first advanced that such tax was imposed upon and paid by the appellee as agent for or on behalf of its shareholders. There are *dicta* in some of the earlier British cases to that effect. However, ever since the decision of the House of Lords in 1921, in the case of *Commissioners of Inland Revenue* v. *Blott* (H. L., 1921), 2 A. C. 171, 8 Tax cases 101, the British law has been to the contrary and the *dicta* purporting to find an agency relationship emphatically repudiated in a long line of more recent decisions. In fact, this theory of agency has been abandoned in this or other proceedings.

Imposition on and Payment by the Shareholder: Failing to sustain the theory of agency, it is now asserted that the tax is actually imposed upon or, at least, paid by the shareholder. Under the British system of taxation, as well as under the American system, there is no tax at the normal or standard rate on dividends. The reason for this is obvious. There are no new or fresh profits to be taxed. Therefore, the only normal tax actually paid to or received by the British Crown is the tax paid by the company on the whole of its profits. Rule 20 does not provide for a new or second tax over and above the tax charged against the "body of persons." After repeating this charge on the "body of persons," the remaining provisions of Rule 20 of the General Rules, Income Tax Act, 1918, have to do and affect only the relationship between the company and the shareholder. *In so doing, such rule has the effect of allowing the company's income tax as a deduction in ascertaining the amount of profits available for distribution as dividends.* It does not levy, charge or impose a tax on the shareholder and no other authority, statutory or otherwise, establishing the imposition of a tax upon the shareholders has been presented or found.

It is contended, however, that, even in spite of the absence of an imposition of a tax, the shareholders pay the tax. Since the only tax paid to the British Crown is the tax imposed upon and paid by the company, it is difficult to conceive how a payment on the part of the shareholders can be made out. *There is no tax at the normal or standard rate imposed on dividends.* There is no legislative authority requiring payment of a tax by the shareholders on the company's profits or on the dividends distributed—other than a surtax. There are no decisions in the English courts holding that the shareholders are liable for any such tax. Payment of the company's tax is not a payment by the shareholders or for the shareholders.

Surtax Liability: It is true that the shareholder in reporting his dividend for *surtax* purposes must add thereto, the tax deducted therefrom if the dividend was declared less tax, or the notional (theoretical) tax if the dividend was declared free of tax. That Parliament saw fit to require a taxpayer to include in gross income for *surtax* purposes his gross or notional dividend, does not prove that the tax on the company's profits was paid by the shareholder or that the shareholder paid a normal tax on his dividends. The statutory provisions of the Act and the decisions are to the contrary. Under the British system, there is no normal tax on dividends and the company pays the normal tax on its profits.

Shareholder's Relief: It is also true that the shareholder, in certain circumstances, may be entitled to a refund of the tax deducted from his dividend if the dividend is a dividend less tax, or of the notional (theoretical) tax if the dividend is a free-of-tax dividend. This refund is made, not because the shareholder paid the company's tax or paid a separate and distinct tax. It is made to the shareholder because, under the British law and for this sole purpose, he is treated as having suffered his collective share of the company's tax. In short, for this one purpose, British law recognizes the theory of the "ultimate burden" and disregards the corporate entity.

Recoupment or Reimbursement: Lastly, it is contended that the company is reimbursed for the tax by or recoups the tax from its shareholders. There is no reimbursement or recoupment. The actual situation is that the payment of the tax by the company, like the payment of any other expense such as rent, salaries, interest, etc., results in there being that much less to distribute to the shareholders. Thus, if a company has a profit of £1,000 before the payment of its tax and pays a tax of 20%, or £200, the profits available to the shareholders amount to £800. Now, it does not matter whether the profits are distributed by a dividend less tax—i. e., a dividend of £1,000 less the tax of £200, or £800—or by a free-of-tax dividend of £800. *The company has received nothing from the shareholders.* It has disbursed its entire profits by paying a tax of £200 and a dividend of £800. It is said that the company has discharged a liability of £1,000 to its shareholders by paying £800. But the declaration of the dividend less tax or the free-of-tax dividend limited the company's liability to £800. Hence, the company has received nothing from its shareholders and has not been reimbursed by them.

The opinions rendered in the British cases of *Commissioners of Inland Revenue* v. *Dalgety & Co., Ltd.,* 15 Tax Cases 216, and *Neumann* v. *Commissioners of Inland Revenue,* 18 Tax Cases 332, 150 Law Times Reports 481, successfully and emphatically answer all of these contentions raised by the appellant and others and conclusively demonstrate that the United Kingdom income tax on the whole of the appellee's profits was imposed upon and paid by it. This is particularly true of the opinions rendered in the House of Lords in the last-mentioned cases, which (decided in 1934) is the latest case bearing on this subject. In such case, the opinions unanimously reverse and disapprove of the dicta in earlier cases and of the contentions of the appellant based thereon.

Finally, it is respectfully submitted that the taxation of corporations and corporate dividends in England and in the United States is fundamentally the same although there are minor differences. For all practical purposes, however, in both countries the tax on the company's whole profits is imposed upon and paid by the company. Those profits when distributed in the form of dividends are not again subject to normal tax. The surtax, if any, on such dividends is then imposed upon and paid by the shareholder. In short, in both countries, the company pays the normal tax on the entire profits and the shareholder pays the surtax on the distributed profits. This fundamental similarity cannot be hidden in the confusion created by emphasizing the minor and unimportant differences and by vague references to taxation at the source. The principle of taxation at the source has nothing to do with the tax on the company's profits (which are subject to normal tax) or the shareholders' dividends (which are not subject to normal tax). Compare Rule 20 with Rules 19 and 21.

Therefore, it is respectfully submitted that the appellee is entitled to deduct the ratable part of the United Kingdom income tax imposed upon and paid by it which is attributable to income from United States sources and that in so determining such ratable part, the amounts deducted from dividend distributions to the appellee's shareholders should not be used to reduce the United Kingdom income tax so paid.

ARGUMENT.

I.

The appellee is entitled to a deduction for foreign taxes imposed upon and paid by it in connection with its income from United States sources.

Under §234(a) (3) of the Revenue Act of 1921, the petitioner is entitled to a deduction in computing its net income for "taxes paid or accrued within the taxable year except * * * so much of the income, war-profits and excess-profits taxes imposed by the authority of any foreign country or possession of the United States as is allowed as a credit under section 238," such deduction being limited only to the extent provided in §234(b).

In determining the deductibility of taxes, the Board of Tax Appeals, our courts and the Treasury Department, have consistently refused to accept the principle of "ultimate burden" and have, instead, laid down the test that—

> "*The taxes deductible are taxes imposed upon and paid by the taxpayer.*"

Thus, in *Small* v. *Commissioner* 27 B. T. A. 1219, the Board denied a deduction of taxes paid by a husband on property belonging to his wife, although he had obligated himself to the mortgagee to pay the taxes upon the property. The Board stated:

> "In order to be entitled to a deduction for taxes paid, a petitioner before us must show not only that he paid the taxes, but that the taxes were *imposed upon him* by the taxing authority. *A. Eisenberg*, 11 B. T. A. 574; *Samuel Riker, Jr.*, 15 B. T. A. 1160; *Caroline T. Kissel*, 15 B. T. A. 1270; *George L. Shearer*, 18 B. T. A. 465; aff'd in *Shearer* v. *Commissioner*, 48 Fed. (2d) 552; *Falk Corp.*, 23 B. T. A. 883; aff'd 60 Fed. (2d) 204; and *Borg & Beck Co.*, 24 B. T. A. 995. The petitioner has not shown that the taxes in question *were imposed upon him.*"

Where petitioner received a certain amount as a prize in a lottery less his share of the Newfoundland Income Tax assessed against the organization running the lottery, the Board, in *Peterson* v. *Commissioner*, 31 B. T. A. 172, denied a credit to the petitioner, stating:

> "*The imposition upon and payment of the tax by the organization conducting the lottery would necessarily reduce the proceeds from the lottery out of which prizes could be paid. This in turn would reduce the amount that would be received by winning ticket holders.* But these facts in and of themselves would not make the tax paid by

> the organization a tax upon the winning ticket holders. For a foreign tax paid to be allowable as a credit against a taxpayer's Federal income tax liability, such foreign tax must have been a tax against the taxpayer and not a tax imposed upon and paid by another on its own account, as was the situation in the instant case. *Elgin National Watch Co.,* 17 B. T. A. 339; *Basil Robillard, Executor,* 20 B. T. A. 685; *Duckworth Co.,* 24 B. T. A. 304." (Italics ours.)

So, whether the question involves a credit or a deduction, a domestic tax or a foreign tax, the test still is—

> *"Was the tax imposed upon and paid by the taxpayer?"*

Imposition without payment or payment without imposition is not sufficient. Further, that the taxpayer may have suffered or borne the tax, or that the ultimate burden of the tax may be his, does not establish imposition and payment within the limits of the Act.

Thus, if a sales tax is levied against a manufacturer, it is included in his cost of production and a consumer is not entitled to any deduction, even though the manufacturer passes the tax on to the consumer as a specific item (*A. R. R. 3041*, C. B. II-2, 110). The Board has so decided in denying to a vendee the deduction of a sales tax on an automobile, even though the tax was actually paid separately by the vendee. *R. C. Musser,* 3 B. T. A. 498; *Hamilton* v. *Commissioner,* 6 B. T. A. 240.

There are numerous rulings by the Treasury Department to the same effect as to stamp taxes, gasoline taxes, sales taxes, etc. Among others, see—

A. R. R. 1020, C. B. I-2, 104—denying the trustees under a will the right to deduct Federal estate taxes paid by them.

S. M. 3714, C. B. IV-2, 50—holding a Wisconsin gasoline tax to be deductible only by the dealer and not by the purchaser who actually paid the same.

I. T. 2768, C. B. XIII-1, 54—to the effect that the Federal liquor tax imposed upon the distiller or importer is not deductible by the stockholders of a company although paid by them when whiskey was withdrawn from bonded warehouses.

Also *I. T. 2790,* C. B. XIII-1, 56; *I. T. 2787,* C. B. XIII-1, 56; *I. T. 2783,* C. B. XIII-1, 54.

Therefore, on these authorities, it is clear that the appellee is entitled to deduct the British income tax on its profits and other income if the tax was imposed upon and paid by it.

II.

The British income tax on the appellee's profits and other income was imposed upon and paid by it and, therefore, constitutes an allowable deduction to the extent permitted by Section 234(b).

The appellee is claiming a deduction under the United States Revenue Act of 1921. The claim is not for relief under British law. Under our law, the deduction or relief is granted to those upon whom the tax was imposed and by whom it was paid. The words, *"imposed upon"* and *"paid,"* have a definite meaning under our law.

If the tax was actually assessed against or levied upon the appellee by the taxing authority of the foreign country, it comes within the requirement of a "tax imposed." If the tax so imposed was also actually paid by the appellee to the taxing authorities, it comes within the requirement of a "tax paid." It is this conception of "imposition" and "payment" which must govern.

The sole purpose of introducing British law into this proceeding is to establish the "imposition" of the British income tax upon the appellee by the taxing authority and the "payment" of such tax to the British Crown within the test laid down by *our* law.

As to "imposition of the tax": Rule 1 of the General Rules, applicable to Schedules A, B, C, D and E contained in the Income Tax Act of 1918, provides:

> "Every body of persons shall be *chargeable to tax* in like manner as any person is chargeable under the provisions of this Act."

Section 237 of the Act, which is the interpretative section, defines *"a body of persons"* to mean, *inter alia, "any company."* Section 106 fixes the responsibility of acting for a *"body of persons chargeable to tax"* upon its officers, and gives every such officer the right to retain out of any money coming into his hands on behalf of the body so much thereof as is sufficient *"to pay the tax charged upon the body* and the right to indemnity for all such payments made in pursuance of the Act.

These provisions are not ambiguous. There is no need to resort to rules of construction, notional income or any other fiction. The tax is *imposed upon* the company as a body of persons. It is liable therefor and it can be sued and the tax recovered as a debt.

Thus, we have here a certain and unambiguous statutory "imposition" of an income tax by a foreign country upon the company (the appellee) within the meaning and intent of our law.

As to the "payment of the tax": That the body of persons—i. e., the company—is liable for payment of the tax is clear from the very statutory provisions which charge it with tax. Under Section 169 of the Income Tax Act, 1918, any tax charged under the provisions of the Act "may be sued for and recovered, with full costs of suit, from the person charged therewith in the High Court as a debt due to the Crown."

As a matter of law, the only possible conclusion is that the income taxes under this Act are imposed upon, paid by, and borne by the company.

That this appellee did, in fact, pay British income taxes for the fiscal and taxable year ending May 31, 1921, has been conceded. Under the stipulation it appears that the appellee paid a British tax of $41,533.05 upon its profits and other income from United States sources.

In conclusion, therefore, it is respectfully submitted that the British income tax on appellee's profits and other income, including its income from United States sources, was clearly "imposed upon" and "paid by" the appellee and that, under our law, the ratable part of such tax attributable to United States income constitutes an allowable deduction as a tax "imposed upon" and "paid by" the appellee.

III.

The British tax so imposed upon the appellee's profits and other income and paid by it, was not imposed upon or paid by its shareholders.

The contention has been advanced in this proceeding or in other proceedings involving questions relative to British taxes, that the British income tax was not imposed upon or paid by the company because Rule 20 of the General Rules of the Income Tax Act, 1918, permits the company, in distributing the profits already taxed, to deduct and retain the tax appropriate to such distribution. Various theories have been advanced to sustain this contention and are discussed in what follows.

The Agency Theory: The rulings known as *S. M. 3040*, reported in C. B. IV-1, at page 198, and *S. M. 5363,* reported in C. B. V-1, at page 89, hold that, under British law, the company pays the tax as agent for or on behalf of the shareholder. This theory is wholly unsound and contrary to British law ever since the case of *Commissioners* v. *Blott* (H. L., 1921), 2 A. C. 171, 8 T. C. 101. It is also understood that this theory has been definitely abandoned and, therefore, further discussion seems unnecessary.

Rule 20 of the General Rules: It is contended that, since the company in paying a dividend is permitted to "deduct" the tax appropriate thereto, the company's tax to that extent is a tax paid by the shareholder and not by the company. This contention is apparently based upon certain "notions" peculiar to English law, viz.: the taxation of the "gross dividend" for surtax purposes and the relief granted or refund made to shareholders of the tax so "deducted" in special cases. However, the question at issue in this proceeding is not fanciful. *It has to do solely with the normal tax upon the company's profits.* With some hesitation, and with some fear of beclouding the issue by comments on the British law applicable to these extraneous matters, the following discussion is entered into with the hope that it may, as already suggested, clear away the fog:

First—Imposition and Payment: If this is a tax on the shareholders within the meaning of our law, there must be an imposition of the tax on the shareholder and a payment by him.

In order to facilitate this discussion, the following illustration will be referred to throughout the remainder of this argument. Assume that a company has a profit of £1,000 in a given year when the standard or normal rate of tax is, say, 2 shillings in the pound, or 10%. The company is assessed under Schedule D on its business or trading profit of £1,000 and pays a tax of £100 to the Collector of Taxes. This leaves £900 in its coffers.

Now, under our conception of corporate accounting and law, the company may declare a dividend of £900. *However, in England, the income tax is regarded both by income tax law and company law as being a disbursement out of profit, and not an expense incurred in the earning of profit.* So, the company may declare a dividend equal to its gross profit less tax, or it may declare a dividend out of its net profit—i. e., after disbursement for income tax. Thus, it may declare a dividend of £1,000 less the tax appropriate thereto of £100, making a net dividend of £900 received by the shareholders. On the other hand, it may simply declare a free-of-tax dividend of £900.

The results in each case are as follows:

	Dividend less tax	*Dividend free-of-tax*
Profits subject to tax......	£1,000	£1,000
Tax thereon at 10%........	100	100
Available for distribution..	£ 900	£ 900
Dividend less tax—Gross..	£1,000	
Tax....	100	
Dividend free-of-tax.......		£ 900
Amount received by shareholders.	£ 900	£ 900

In both cases, the company earned £1,000, paid a tax of £100, and distributed £900 to its shareholders.

Now, it is important to remember that the tax of £100 was assessed against—i. e., "imposed upon" —the company and paid by it; and that this was the only normal or standard tax paid to or received by the British Crown, in respect of such income.

Therefore, it is difficult to understand how there can be an imposition on and payment of a tax of £100 by the company and at the same time the imposition on and payment of a tax of £100 by the shareholder, when in fact and in law only one tax—

the company's tax—of £100 was ever assessed by and paid to the British Crown. Hence, it remains to be seen whether this same tax is also imposed upon and paid by the shareholder.

The authority under which the company "deducts" the tax from a dividend declared less tax is Rule 20 of the General Rules, which provides as follows:

> "The profits or gains to be charged on any body of persons shall be computed in accordance with the provisions of this Act on the full amount of the same before any dividend thereof is made in respect of any share, right or title thereto, and the body of persons paying such dividend shall be entitled to deduct the tax appropriate thereto."

The effect of this rule is permissive. It does not impose, levy or charge a tax against the shareholder. It does not fix any liability on the shareholder if the company fails to pay the tax. It neither requires the declaration of dividends nor the deduction of the tax. It merely permits a company to deduct the tax, which has been assessed on its profits, from those profits before making a distribution thereof to its shareholders; otherwise, the shareholders might demand a full distribution of the profits and leave the company to charge the tax to its capital.

Rule 20 does not provide for a new or second tax. To do so would be unreasonable, since there are no new or fresh profits to be taxed. The only tax imposed by Rule 20 is the tax charged against the "body of persons."

In short, Rule 20 affects only the relationship between the company and the shareholder. The company pays the tax of £100 to the Crown, and from then on the Crown is not interested in how the company distributes the balance of its profits. It may distribute £1,000 less the tax of £100, or £900; or it may distribute £900 free of tax. The result is the same.

As between the company and the shareholder, the "deduction" of tax under Rule 20 merely has the effect of allowing the company income tax as a deduction in ascertaining the amount of profits available for distribution as dividends. As Mr. Justice Rowlatt aptly said, in *Purdie* v. *Rex* (1914), 3 K. B. 112, 111 Law Times Reports 531—

> "The company has to pay income tax on its profits as a company, and having paid income tax, the result is there is less to divide among the shareholders."

Hence, it is submitted that Rule 20 does not impose or charge a tax upon the shareholders and no other authority, statutory or otherwise, establishing the imposition of a tax upon the shareholders has been presented or found.

In spite of the absence of any "imposition," it has been vigorously maintained that the shareholders pay a tax on their dividends and, therefore, the contentions in respect to *"payment"* should also be given careful consideration.

It has already been shown that the only tax actually paid to the British Crown was the £100 paid by the company. *The company, in paying this tax, did not do so as agent for or on behalf of the shareholders.*

Commissioners v. *Blott,* (H. L. 1921) 2 A. C. 171; 8 T. C. 101;

Bradbury v. *English Sewing Cotton Company, Ltd.,* (H. L. 1923) A. C. 744; 8 T. C. 481;

Gold Fields American Development Company, Ltd., v. *Consolidated Gold Fields of South Africa, Ltd.,* 135 Law Times Reports 14;

Ritson v. *Phillips,* (1924) 131 Law Times Reports; 9 T. C. 10;

Hamilton v. *Commissioners,* 16 T. C. 213;

Neumann v. *Commissioners,* (1934) 18 T. C. 332; 150 Law Times Reports 481.

Since the only tax paid to the foreign country (United Kingdom) was the tax imposed upon and paid by the company, it is difficult to conceive how a payment on the part of the shareholders can be made out.

Still, it is vigorously asserted that the tax "deducted" from a dividend less tax and the tax added to a free-of-tax dividend to arrive at the "notional gross" is a tax paid by the shareholders. The only possible basis for such contention is that the shareholder-recipient suffered a deduction. In other words, the shareholder received a smaller dividend because the company had to pay a tax on its profits and therefore may be said to have suffered, borne and, in that sense, paid a tax. *This is nothing more than a vivid illustration of the "ultimate burden" theory which the Board and our courts have rejected time and time again.* It is perhaps a little more vivid because the shareholder receives a certificate showing the gross dividend, the tax appropriate thereto and the net dividend. However, it is no more so than where the vendees of the automobiles in the case of *In re Musser*, 3 B. T. A. 498, and *Hamilton* v. *Commissioners*, 6 B. T. A. 240, had receipts showing the amounts of the automobile taxes included in or added to the purchase price of the cars.

Therefore, under our conception of what constitutes a payment of tax—i. e., the actual payment of a tax to a taxing authority—there has been no payment of a tax by the shareholders.

It has also been stated that this conclusion of a payment of a tax is based on "legislative authority," "judicial authority," and "the practice of the Inland Revenue Department."

As to the legislative view, reference is first made to Section 27 of the Finance Act of 1920, in which the words, "has paid, by deduction or otherwise," appear. Reference is next made to Section 12(3) of the Finance Act of 1930 in which the words, "deemed to have been paid by deduction," appear. Finally, a quotation is made from Section 33 of the Income Tax Act of 1918 in which there are the words, "has been charged to tax by deduction or otherwise." Taking these words, it is argued that in the view of the English legislature a deduction of tax is a payment of tax.

These sections are utterly immaterial to the question here. Section 27 of the Finance Act of 1920 has to do with the relief to be allowed for Dominion income tax. Section 33 of the Income Tax Act, 1918, has to do with the relief to be granted life assurance companies for life expenses of management. Section 12(3) of the Finance Act of 1930 has to do with the computation of the "gross dividend" as *income* when the tax "deducted" under Rule 20 has been less or greater than the standard rate.

Not one of such sections provides directly for payment of a tax on dividends at the source as in the case of interest or rent, or as in the case of the tax upon the profits of the company. Not one of such sections indicates or contemplates that a shareholder is personally liable or must pay a tax to the United Kingdom on his dividends.

It is most significant that there is an entire absence of statutory authority for the direct imposition of a tax upon shareholders and providing for payment by the shareholders and enforcement of such payment against the shareholders.

For judicial authority as sustaining a payment of the tax by the shareholders, the following cases have been relied upon:

> *Marion Brooke* v. *Commissioners of Inland Revenue,* (1918) 115 Law Times Reports 715; 7 T. C. 261;
> *Williams* v. *Singer,* 7 T. C. 402; (1918) 2 K. B. 749; (1919) 2 K. B. 108; (1920) 36 T. L. R. 661;
> *Hamilton* v. *Commissioners,* 16 T. C. 213.

Other cases which have been referred to are:

> *Attorney General* v. *Ashton Gas Co., Ltd.,* (1904) 2 C. H. 62;
> *Samuel* v. *Commissioners,* 7 T. C. 277;
> *Commissioners* v. *Blott,* 1921, 2 A. C. 171;
> *Neumann* v. *Commissioners,* 18 T. C. 332;
> *Ritson* v. *Phillips,* 9 T. C. 10;
> *Purdie* v. *Rex,* (1914) 3 K. B. 112; 111 Law Times Reports 531.

None of these cases establishes that the shareholders paid a normal tax on the profits of the company or on their dividends, or that a tax was paid on their behalf to the United Kingdom. Prior to the *Blott* case in 1921, there are dicta in some of the cases—of which the *Brooke* case and the *Samuel* case are examples—to the effect that the company in paying the tax on its profits did so as agent for its shareholders; although on this point even the earlier cases were not all in harmony—see *Purdie v. Rex.* However, ever since the *Blott* case, it has been held time and time again that the company is the taxpayer when it pays the tax to the Crown and does not pay such tax as agent for the shareholders—see the cases of *Blott, Hamilton, Neumann* and *Ritson,* among others.

Statements in the opinions to the effect that the shareholder pays a tax by "deduction"—i. e., suffers a tax—or that the company in "deducting" the tax from dividends acts as collector of the tax, are misleading. The tax so "deducted" or "collected" never reaches the Crown. It is retained by the company if the company can be said to retain what it never actually physically receives. There is therefore no payment of a tax by the shareholders to the British Crown within our understanding and construction of the word, "paid." No amount of citation of cases or quotations of dicta from the English cases or expert theorizing can overcome the total absence of any proof of a payment of a tax by the shareholders or on their behalf within the meaning of our law.

As to the practice of the Inland Revenue Department, it appears that the Department refunds or repays to a shareholder entitled to relief the tax "deducted" from a dividend, paid less tax or the tax added to a free-of-tax dividend. The fact that such relief is granted irrespective of whether the tax is "deducted" or not, brings out more forcibly than ever the marked distinction between what constitutes a payment of tax under English law and such a payment under American law. The company, having £1,000 in profits, pays a tax of £100. It then declares a free-of-tax dividend of £900, and the shareholder receives £900. Under both English and American law, the company is the taxpayer in respect to this £100 tax. In the United States, the shareholder would pay a surtax on £900, but in England would pay a surtax on £1,000. This £1,000 is arrived at by a "grossing-up" process which adds the tax necessary to arrive at the "notional gross." However, under English law, this notional (theoretical) tax which was not even deducted by the company is considered for the purposes of relief as a tax paid. Since the shareholder is not subject to a normal or standard tax on his dividends, it is assumed that he paid this notional (theoretical) tax and he is allowed a credit of £100. If because of the smallness of his income he is not subject to tax, he is entitled to a repayment of this £100.

There is another illustration which clearly establishes that this relief is not based upon an actual tax payment within the meaning of our law. Assume that a company has a profit in one year of £1,000 and pays a tax for that year at 10%, or £100. It does not declare a dividend until the following year, when the tax rate is 25%. It then declares a dividend of £1,000 less tax of £250, making a net dividend of £750; or it declares a free-of-tax dividend of £750. Irrespective of the form of the which was ever paid on this income was the £100 paid by the company in the previous year, the

Inland Revenue Department will refund or repay to the shareholder £250 if he is wholly exempt. That this is so, appears from the following quotation from the opinion of Lord Tomlin in *Neumann v. Commissioners of Inland Revenue,* (1934) 18 Tax Cases 332, 150 Law Times Reports 481:

> "At any rate, a practice seems to have grown up of companies deducting from dividends tax appropriate to the amount of the dividend at the current rate of tax, quite irrespective of the amount of tax paid by the company to the Revenue, and of the shareholders claiming exemption or abatement being treated by the Revenue as having paid tax to the extent of that deduction. As the company making the deduction lay under no obligation to pay to the Revenue anything more than the tax based upon its own assessment, the result was that the tax returned to those claiming exemption or abatement could rarely, if ever, have had any exact relation to the amount of tax received by the Revenue from the recipient of returned tax."
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> * * * * * *
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> "Thus, the deduction permissible from the dividend clearly had no relation to the figure of tax payable by the company to the Revenue for what was deducted. The deduction, in fact, was only part of a system by which was measured (1) the extent of the shareholders' right to have exemption or abatement, and (2) the liability of the shareholder to Sur-tax."

Under our law, which considers the amount paid to the taxing authority, the only tax paid was that paid by the company of £100 and at no time was a tax of £250 paid. Therefore, it is submitted that the English conception of a tax payment of £250 cannot be accepted. The practice of the Inland Revenue Department cannot be used to establish the payment of a tax by or on behalf of the shareholder to the taxing authority when, in fact, no such tax has been paid.

Second—Shareholder's Liability for Surtax: Since the dividend when received by the shareholder has borne the normal or standard tax in the hands of the company, it is not again subject to a normal or standard tax in the hands of the shareholder. It is, however, subject to surtax in his hands. Further, it appears that the shareholder is subject to surtax on the "gross dividends"—i. e., the net dividend received plus the tax appropriate thereto. For this purpose, a dividend less tax and a free-of-tax dividend are treated the same. This is accomplished by applying to the free-of-tax dividend what is known as the "grossing-up process." That is, such a sum is added to the free-of-tax dividend as may be necessary to arrive at a gross dividend which less the tax would equal the free-of-tax dividend. This is referred to as a "notional gross."

So, in the illustration given, the shareholder would be held to have received a gross dividend, whether less tax or free-of-tax, of £1,000. He would not be subject to a tax at the normal or standard rate. He would, however, if liable therefor, pay a surtax on the amount of £1,000 and not on the £900 actually received. *But the question at issue does not have to do with surtaxes.* Parliament and the English courts could and had the power to determine what constituted income for surtax purposes. They are not limited by a written Constitution or by a decision equivalent to our *Eisner* v. *Macomber*, 252 U. S. 189. It has been decided in England time and again that the shareholder is liable for surtaxes on this gross or notional gross dividend and it is conceded by all parties that the surtax is imposed upon and paid by the shareholders.

> *Brooke* v. *Inland Revenue Commissioners*, 7 Tax Cases 261;
> *Williams* v. *Singer*, 7 Tax Cases 387;
> *Hamilton* v. *Commissioners*, 16 Tax Cases 213;
> *Samuel* v. *Commissioners*, 7 Tax Cases 277.

However, this does not prove or establish that the tax at the normal or standard rate "deducted" from the dividend less tax or added to the free-of-tax dividend in the grossing-up process was a tax *imposed upon* or *paid by* the shareholder. *On the profits of £1,000 earned by the corporation only one tax of £100 is imposed and paid—i. e., the tax imposed upon and paid by the corporation.*

Third—The Relief Granted the Shareholder: Much has been made of the refunds made to shareholders of the tax "deducted" from their dividends or of the notional (theoretical) tax added to their free-of-tax dividends when it appears that the shareholder is exempt from tax. This subject has also been touched upon above. A few brief additional comments may serve to clear up this peculiarity of the British practice.

These refunds are apparently a result of the policy of British law which recognizes, for this special purpose, that the shareholder bears the ultimate burden of the corporate income tax. In short, this is a special situation in which the "corporate entity" theory is ignored. These refunds are made, not because the shareholder has actually "paid" the "deducted" tax, but because he is deemed to have "borne" his share of the corporate tax. The tax so refunded is, in effect, a part of the tax that was imposed on and paid by the company. And, since the shareholder receives the refund in such cases, the company is utterly unaffected in the matter of its own tax payment.

The concept upon which the relief is based is described by Mr. Justice Rowlatt in *Ritson* v. *Phillips* (1924), 131 L. T. 384, 9 Tax Cases 10, as follows:

> "He is not taxed on his dividends. The companies are taxed on their profits not as his agents (as has been loosely said), though at his ultimate expense. There is no provision for the return of any of this tax to the shareholder save in the process of giving effect to deductions and reliefs."

The following is quoted from the opinion of Lord Phillimore in *Bradbury* (*Collector of Taxes*) v. *English Sewing Cotton Company, Ltd.* (House of Lords, 1923), 8 Tax Cases 481; 1923 A. C. 744:

> "Their taxation would seem to be logical, but it would be destructive of joint stock company enterprise, so the Act of 1842 has apparently proceeded on the idea that for revenue purposes a joint stock company should be treated as a large partnership, so that the payment of Income Tax by a company would discharge the quasi-partners. The reason for their discharge may be the avoidance of increased taxation. But the

> law is not founded upon the introduction of some equitable principle as modifying the Statute; it is founded upon the provisions of the Statute itself; and the Statute carries the analogy of a partnership further, for it contemplates a company declaring a dividend on the gross gains, and then on the fact of the dividend warrant making a proportionate deduction in respect of the duty, so that the shareholder whose total income is so small that he is exempt from Income Tax or pays at a lower rate can get the Income Tax which has been deducted on the dividend warrant returned to him."

These quotations clearly indicate that such refunds are made on the theory that the shareholder bore his proportionate share of the collective corporate income tax and not because of an individual payment of a tax. Hence, this peculiarity of the English law does not prove an imposition on or payment of tax by the shareholder within the meaning of our law.

On the final analysis, therefore, the conclusion that the shareholders pay a tax on their dividends is, at most, a conclusion based on the English conception of what constitutes a tax payment. There is nothing in the legislative provisions, the court decisions or the practice of the Inland Revenue Department that indicates or establishes a liability of the shareholder to the Government for a tax or that a payment of a tax is made to the Government by the shareholder or on his behalf other than the surtax. The fact is that the opinions expressed in the English cases are to the contrary.

It apparently has never been necessary in England to determine whether the company or the shareholder pays the tax on the company's profits. It is hard to see how any such question could arise. The Income Tax Act, 1918, imposes the normal tax on the company and the Crown collects the tax from the company. In proper cases, a surtax is imposed upon the shareholder and the Crown collects the surtax from the shareholder. There is no room for controversy as to upon whom each of these separate liabilities is imposed or who shall pay or did pay these separate and distinct taxes.

The nearest approach to a decision on this question is that in the case of *Commissioners of Inland Revenue* v. *Dalgety and Co., Ltd.*, 15 Tax Cases 216. Briefly, in such case the company contended that it had paid United Kingdom income tax on that part of its Australian income which was disbursed by way of interest to its debenture-holders and therefore that it was entitled to the relief granted by Section 27 of the Finance Act of 1920, which provides:

> "If any person who has paid, by deduction or otherwise, or is liable to pay, United Kingdom income tax for any year of assessment on any part of his income proves * * * that he has paid Dominion income tax for that year in respect of the same part of his income, he shall be entitled to relief from United Kingdom income tax paid or payable by him on that part of his income at a rate thereon to be determined * * *."

The company had paid Australian income tax on its Australian income and, like all other companies in England, had paid or was liable to pay a United Kingdom income tax by deduction or otherwise on its total profits including its Australian profits.

The company disbursed part of its Australian profits as interest to its debenture-holders and, in so doing, deducted the United Kingdom income tax appropriate thereto. The Crown contended that the company was not entitled to relief because it had not borne the United Kingdom income tax on such profits since it had "recovered" such tax by "deducting" a tax on the payment of the debenture interest, or in short that the tax was ultimately borne by the debenture-holders. This contention was phrased by Lord Warrington in the House of Lords as follows (p. 249):

> "The Respondents have deducted from the interest payable to the debenture-holders the United Kingdom tax in respect of that interest and it is said they have thus recovered a corresponding portion of the United Kingdom income tax paid or payable by them in respect of the profits from their Dominion trade and ought not therefore to be treated as having paid United Kingdom tax on the whole of such profits."

This is the same as the contention advanced here—namely, that the appellee having "deducted" a tax from its dividend distributions should not be treated as having paid United Kingdom tax on the whole of its profits. The House of Lords forcibly and in no uncertain terms rejected this contention and held that the company must be treated as having paid the United Kingdom tax on the whole of its profits. Thus, Justice Lawrence, in his opinion in the Court of Appeals, stated (p. 238):

> "The Company has in the natural and literal sense paid both the United Kingdom Income Tax and the Dominion Income Tax.

> No one else has paid or become liable to pay both these taxes, and no one else can claim relief under the relevant Sections."

Lord Warrington, in the House of Lords, said (p. 249):

> "The Respondents' contention is a simple one. The Company is a person who has paid or is liable to pay United Kingdom Income Tax on part of his income, viz., in this case the trading profits earned in the Dominions, and has also paid Dominion Income Tax on the same part of his income, and is therefore entitled to relief from United Kingdom Income Tax payable on that part of his income. Reading the words of the statute in their ordinary and natural meaning there is no answer to this contention."

As further indication of the trend of English opinion of the respective liabilities of the company and the shareholder, the following quotations from the opinions in certain cases are very material, if not conclusive.

Judge Rowlatt in *Ritson* v. *Phillips* (1924), 131 L. T. 384; 9 Tax Cases 10:

> "He is not taxed on his dividends. The companies are taxed on their profits not as his agents (as has been loosely said), though at his ultimate expense."

Judge Rowlatt, again, in *Purdie* v. *Rex* (1914), 3 K. B. 112, 111 L. T. R. 531:

> "So that in effect the company is the taxpayer. There is strictly speaking no income tax on dividends at all. The company has

> to pay income tax on its profits as a company, and having paid income tax, the result is there is less to divide among shareholders."

Lord Phillimore, in *Bradbury (Collector of Taxes)* v. *English Sewing Cotton Company, Ltd.* (House of Lords, 1923), 8 Tax Cases 481, at page 520:

> "A company either comes under Section 40 of the Act of 1842, or it does not. If it does not, it is not taxable; but in that event those who receive dividends from it will be taxable in respect of their dividends. *If it does come under Section 40, its shareholders are not taxable for their dividends.* This is so, not because of any implied rule of law against double taxation, a rule for which it would be difficult to find support in the books, but because dividends on shares in a taxed company do not come under Schedule D." (Italics ours.)

Particular attention is called to the opinion of Lord Wright, in *Neumann* v. *Commissioners of Inland Revenue* (1934), 18 Tax Cases 332, 150 Law Times Reports 481, from which the following is quoted:

> "The scheme of these provisions, as I understand them, is to impose the tax on all the profits of the company at the source; if and so far as these profits have been so taxed, they are not liable to any further tax, other than surtax, in the hands of the shareholder receiving the dividend. The shareholder and the company are, no doubt, separate entities; the company is not an agent for the shareholder to pay tax on the dividend, nor is the company the collector for

> the revenue to deduct the tax from the dividend. The company is the taxpayer. * * * The company is not bound, but only authorized, to deduct tax in paying dividends: whether it deducts or not is left to its discretion, because the profits, once having been taxed in the company's hands, do not bear further tax—apart from surtax—in the shareholders' hands. There is, in fact, only one profit, no new profit being created from the fact that the shareholder gets his share; the tax is a tax on the profits and not on the dividend."

On these authorities and on the provisions of the Income Tax Act and the actual facts of imposition and payment of the tax, the following conclusions are fully justified:

1—*That the company is the taxpayer upon whom the tax was imposed and by whom the tax was paid in respect of its profits and income.*

2—*That there was no tax imposed upon or paid by the shareholder in respect of dividends, other than a possible surtax.*

Recoupment or Reimbursement: The last contention advanced is that the appellee is not entitled to a deduction for the United Kingdom income tax to the extent that it recoups or recovers the tax from its shareholders. Clearly, this is grasping at straws.

It is absurd to contend that the company has actually been reimbursed for the tax merely by distributing a dividend less tax—a bookeeping transaction. Assume that two companies each have a capital of £1,000,000 and each have earnings before payment of the British tax of £100,000. The British tax is, say, 20%, or £20,000, leaving £80,000 available for distribution, which it is decided to distribute. Company "A" declares a dividend of 10%, less tax, and Company "B" declares a free-of-tax dividend of 8%. The figures would then be as follows:

		Company "A"	*Company "B"*
Net earnings..................		£100,000	£100,000
British tax paid..............		20,000	20,000
Available profits..............		£ 80,000	£ 80,000
Dividend at 10%.....	£100,000		
Less tax at 20%.....	20,000	80,000	
Dividend at 8%..............			80,000
Undistributed earnings........		None	None

In both cases, the company's assets remain exactly the same and exactly the same amount of cash is paid to the British Crown as a tax on the company's profits and exactly the same amount of cash is paid out to the shareholders. Yet, under the theory advanced, Company "A" is deemed to have recouped the tax and Company "B" is not deemed to have recouped the tax. Nothing of the sort has happened.

The shareholders have in each case received all they were entitled to. A fanciful argument has been broached to the effect that Company "A" has been reimbursed because it discharged a liability of £100,000 to its shareholders by a payment of £80,000. This presumes a liability upon the company to pay its shareholders £100,000, but the very form of the dividend declaration limited its liability to £80,000. This form of dividend declaration protects the company from having to pay the income tax out of capital. It is merely another form for distributing the profits of the company *after* the payment of income tax. It never created a debtor-creditor relationship between the shareholders and the company to the extent of £100,000. The liability to pay such amount never having been created, it cannot be said that the company has been discharged from such a liability by a cash payment of £80,000 and the waiver of such fictitious liability by the shareholders to the extent of £20,000. The shareholders cannot be considered as having waived or forgiven a debt or liability which they were not entitled to receive and which never existed.

The liabilities intended to be and actually created in both cases were to pay the British Crown a tax of £20,000 and to pay the shareholders £80,000. These liabilities were discharged by cash payments and, upon their discharge, no recoupment was made to or reimbursement received by either of the companies.

However, even if there were a recoupment or reimbursement, the company still is entitled to claim the deduction of the tax since it was imposed upon and paid by it. We have many examples in this country where the manufacturer, the dealer or distributor passes a tax on to the purchaser and yet has been held entitled to deduct the tax because it was imposed upon and paid by him. True, he must include the full sales price, inclusive of the tax in his income. So, here, the company is taxed on its whole profits without the benefit of a deduction for the tax paid or the dividend declared. Hence, in both cases, the total profit is taxed and the person upon whom the tax is imposed and by whom it is paid is held entitled to the tax deduction although the ultimate burden of the tax may be on another.

But the ultimate burden of the United Kingdom tax on the British company's profits is no more of a burden on the shareholder in the British company, than is the United States corporate tax a burden on the shareholder in an American company. *In both cases, there is just that much less to distribute to the shareholders.* No one would seriously contend that the shareholder in the American company pays the corporate tax or reimburses the corporation. Similarly, it cannot be said that the shareholder in the British company pays the tax of the British company or reimburses it.

Therefore, in conclusion, it is respectfully submitted that—

1—*The appellee did not pay the United Kingdom income tax on its profits as agent for or on behalf of its shareholders.*

2—*That such tax was not imposed upon or paid by the appellee's shareholders, but was imposed upon and paid by the appellee.*

3—*That the appellee did not recoup such tax from nor was it reimbursed for such tax by its shareholders.*

IV.

Finally, the similarity of the taxation of corporate profits and the distribution thereof in the form of dividends under American law and British law, points to the only possible, feasible and practical conclusion which can be justified as a matter of law.

It has been stated that "taxation is an intensely practical matter and the law in respect thereto should be construed in a practical way." *Central Life Society* v. *Commissioner of Internal Revenue*, 51 Fed. (2d) 939. This suggestion of keeping practical considerations in mind is peculiarly applicable to the whole British tax question. Compare, from a practical standpoint, the taxation in the United States of a domestic corporation and its dividend distributions with the taxation in England of a British corporation and its dividend distributions.

Assume that a domestic corporation has net profits of $100,000 before payments of its corporate income tax. For the year 1930, it pays a tax of 12%, or $12,000, leaving $88,000 available for dividends. Upon payment of $88,000 as a dividend, there are no earnings left to carry to surplus or capital. The shareholder upon receiving the dividend of $88,000 does not pay a normal tax thereon. His liability is confined to a surtax upon $88,000, say, of 10%, or $8,800. Thus, it is clear that the corporation pays the normal tax and a dividend which, in the aggregate, equal its total profit and that the shareholder pays the surtax.

Now, assume that a British corporation has a profit of £100,000 before payment of the United Kingdom income tax. It pays a tax of 20%, or £20,000, leaving £80,000 available for dividends. Upon payment of £80,000 to its shareholders, whether pursuant to a less-tax or free-of-tax dividend, there are no earnings left to carry to surplus or capital. The shareholder receiving the dividend does not pay a normal tax but is subject to a surtax upon the gross amount of £100,000 and such tax, say, at 10%, would be £10,000.

In short, in both cases the company has paid a tax on its total profits, has distributed the balance by way of dividends and the shareholder has become liable to and has paid the surtax.

Since the appellant is of the opinion that there is some relationship between the British tax credit or deduction to be allowed the American shareholder of a British company and the British tax deduction allowed the British company and since such question has been raised in the shareholders' cases mentioned at the outset, it is thought proper to present the following conclusions and discussion:

(1) The United Kingdom income tax on the whole of the profits of a British company is imposed upon and paid by the company.

(2) Therefore, the company is the one entitled to deduct such tax if and to the extent that it is connected with income from United States sources.

(3) The shareholder in the British company does not pay any part of the company's tax and, in fact, does not pay a normal tax on dividends received by him.

(4) However, the income received by the American shareholder under our law is not the gross or notional dividend arrived at for surtax purposes under British law, but the actual dividend received.

(5) Any United Kingdom surtax paid by the shareholder is an allowable tax credit or deduction, as the case may be.

It may be contended that this results in a double deduction of the same tax, in that the British company is permitted to deduct the tax and the shareholder by including only his net dividend in income also receives the benefit of the deduction of the tax. This contention strikes at the very crux of the whole question. It indicates that the difficulty which has arisen is due to a misconception of income as well as of the identity of the taxpayer. Taking the view that the "gross dividend" is the shareholder's income, it becomes necessary, in order to avoid excessive taxation, to resort to the fiction that he paid a United Kingdom income tax on such dividend. However, he *did not pay* such a tax—there is no United Kingdom income tax on dividends—and the difference between the "net dividend" received by the shareholder and the "gross" or "notional dividend" was never income to the shareholder. This difference merely represents his collective share of the tax paid by the company on the profits of the company so far as distributed. *Such difference has no place in the gross income to be reported for Federal income tax purposes.*

In the United States, we do not add to the shareholder's gross income the tax paid by the company. Such tax is treated as a disbursement by the company in earning income. The fact that England treats this item as income solely for surtax purposes does not require a shareholder to report as income in the United States what he never receives and what is not income. Thus, so far as our conception of income is concerned, the shareholder has received a dividend equal to the "net dividend" shown on his dividend warrant.

That there may be no doubt as to this, attention is again called to the fact that in England the income tax is regarded both by income tax law and company law as being a disbursement out of profits and not an expense incurred in the earning of profits. With this in mind the mechanics of Rule 20 are more clearly understood. It permits the company to retain out of the profits to be distributed to shareholders sufficient funds to pay the company's income tax. This is nothing more than a roundabout way of arriving at a distribution of the net profits which is the practice followed in this country. Here, the company pays the tax and declares a dividend out of the net profits left after paying the tax. In England, the company pays the tax, but declares the dividend out of the gross profits before deducting the tax and then reduces the declared "gross dividend" by the amount of the tax. The result in each case is the same. Both companies *pay* the tax on their entire profits and both *pay,* in cash, a dividend out of profits available after the payment of the tax.

Return to the illustration of a company having a profit of £1,000 and paying a tax of 10%, or £100, and distributing £900 to its shareholders. Irrespective of the fact that, under British law, the shareholders are said to have received for surtax purposes a gross or notional dividend (income) of £1,000—i. e., £900 in cash plus their collective share of the company's tax—it remains that, except for this one purpose, the shareholders' income was not and could not be more than £900. It is this "net dividend" that is and should be treated as taxable income under our law.

However, if the company is also taxed on its income of £1,000, then neither the shareholder nor the company has been allowed the deduction. In short, the company's net income in the illustration given was £900 and, since it distributed £900 to its shareholders, that was also the shareholder's income. If a company distributes all its profits for a given year, it necessarily follows that the net income of the company will equal the dividend received by the shareholders.

The appellant would say that both the shareholder and the company had income of £1,000 and that the shareholder paid the company's tax of £100. This is so obviously in error from all points of view as to disprove his entire argument.

There is no provision in our law that requires us to treat the relationship between a British company and its shareholders differently from the relationship between a domestic company and its shareholders. Our conception of the income of the company and the income of the shareholder and of the respective taxes paid by each determines the income and deductions to be reported by each for Federal income tax purposes. Under our law and practice, the shareholder in the British or domestic company does not pay the company's tax (i. e., the tax imposed on and paid by the company) nor is he considered as having received a gross or notional dividend over and above the actual dividend paid to him. As to deductions, the shareholder in the British or domestic company is not entitled to a tax credit or deduction for a tax imposed upon and paid by the company. Therefore, under our law, the British company is considered as the taxpayer and the shareholder in such a company is considered as having received a dividend equal to the so-called "net dividend." Further, as has been shown, there is nothing in the British law, the British cases or the practice of the Inland Revenue Department which requires a holding to the contrary.

V.

There are no decisions or rulings on the precise British tax question at issue binding upon this Court.

Much has been made as to the practice of the Internal Revenue Bureau prior to December, 1933, and the rulings *S. M. 3040,* C. B. IV-1, 198, and *S. M. 5363,* C. B. V-1, 89. Undoubtedly, the practice of the Bureau prior to December, 1933, was based on such rulings.

The Solicitor of Internal Revenue, in arriving at his conclusions in *S. M. 3040* and *S. M. 5363,* relied, not upon the statutory provisions of the British Income Tax Act, but upon certain language loosely used in comparatively old British cases. Thus, in *S. M. 3040,* it was held that—

> "*In view of these decisions,* it is the opinion of this office that where under the income tax act, 1918, of Great Britain, a tax is paid to the British Government by a corporation

> on the basis of its profits and gains which is deductible by the corporation from the dividends paid its shareholders, such tax is a tax against the shareholders and may be taken as a credit by a citizen shareholder of the United States under section 222 of the Revenue Acts of 1918 and 1921. *Although the corporation is held chargeable to tax, the decisions cited above construe the provision permitting the deduction of taxes from dividends as being a payment of tax on behalf of the shareholders, or a collection at the source.*"

Subsequently, a foreign company requested a reconsideration of *S. M. 3040* in view of the decision of the highest court in England in *Commissioners of Inland Revenue* v. *Blott* (H. L., 1921), 2 A. C. 171. The Solicitor, in *S. M. 5363,* reaffirmed its previous opinion, dismissing such decision with the mere statement that, "it is the opinion of this office that the Blott decision in no way affects the soundness of the conclusion." This in spite of the fact that the *Blott decision* became the accepted law and has been followed ever since.

In short, the British decisions relied upon by the Solicitor, even if in point—which they are not—were all made prior to 1919. The particular language used in such decisions and forming the basis of the Solicitor's conclusions had been expressly overruled even at the time the Solicitor rendered his second opinion. Hence, his interpretation of British law, reached solely by refusing to recognize the leading British decision in the *Blott case,* is not only unsound, but should be reversed.

These rulings of the Bureau are not conclusive on the Board of Tax Appeals or on this Court and there have been many occasions when similar rulings have been reversed. Further, such rulings have not taken the force of law by reason of Congressional re-enactments of the statutes. Where the law is plain, the doctrine of adoption of departmental construction by subsequent re-enactment does not apply.

> *Hamilton* v. *Rathbone,* 175 U. S. 414, 419;
> *Thompson* v. *United States,* 246 U. S. 547, 551;
> *United States* v. *Hartwell,* 6 Wall. 385, 396;
> *Helvering* v. *New York Trust Company as Trustee of Matthiessen,* 292 U. S. 455;
> *Central Real Estate Company* v. *Commissioner,* 47 Fed. (2d) 1036;
> *Iselin* v. *United States,* 270 U. S. 245, 251;
> *United States* v. *Graham,* 110 U. S. 219, 221.

Further, Bureau rulings "have none of the force or effect of Treasury decisions and do not commit the Department to any interpretation of the law."

> *Helvering* v. *New York Trust Company as Trustee of Matthiessen, supra.*

If the Bureau's own rulings do not even commit the Bureau, how much less are they binding or conclusive on this Court.

The case of *Basil Robillard* v. *Commissioner,* 20 B. T. A. 685, affirmed 50 Fed. (2d) 1083, has been cited as decisive of the issue here. It is contended that this case upholds the allowance to a shareholder of a British corporation of a credit for the British tax paid on his dividend. That was not the question at issue in such case. The sole issue involved, as stated by the Board, was—

> "whether or not petitioner, a resident and citizen of the United States, is entitled to credit, against United States income taxes, taxes paid to the British Government by a Canadian corporation of which petitioner was a stockholder."

The petitioner in such case claimed such deduction under §222(a) (4) of the Revenue Acts of 1924 and 1926 on the ground that, since Spirella Securities, Ltd., of Canada, was a holding company rather than an operating company, decedent stockholder was the beneficiary of a trust within the meaning of the above section and was therefore entitled to a credit. In denying such credit the Board was not required to consider whether the British corporation was the taxpayer to the extent of the entire tax paid on its profits. The Board reached the conclusion that Spirella Securities, Ltd., was an ordinary holding corporation and that its stockholders occupied no different status from stockholders of such corporations generally. In these circumstances, as stated by the Board, Spirella Securities, Ltd., owned the stock in Spirella Co. of Great Britain and the dividends received on that stock belonged in the first instance to it. Therefore, the Board finally concluded with the statement that—

> "We know of no authority of law which would permit its stockholders to take credit against their own liability for such taxes paid on the theory that they are beneficiaries

> of a trust within the meaning of section 222(a) (4), quoted at the beginning of this opinion."

And later:

> "Petitioner should be taxed only on the amounts actually received from Spirella Securities, Ltd., of Canada, without any credit against the tax for foreign taxes paid by the Spirella Co. of Great Britain in dividends disbursed to Spirella Securities Co., Ltd., on stock owned by it. In other words, the dividends received by petitioner's decedent from Spirella Securities, Ltd., should be taxed as income to petitioner without reference to any foreign tax which had been paid by Spirella Co. of Great Britain for account of Spirella Securities, Ltd., of Canada."

Thus a careful analysis of the issue involved and the Board's decision on such issue clearly establishes that it is not material to or conclusive of the issue herein.

It is true that the Board in the course of its opinion did state, apparently pursuant to paragraph "5" of the stipulation, on page 687, that the "petitioner should be allowed credit against the tax of income taxes paid to the British Government by the Spirella Co. of Great Britain on dividends disbursed direct to petitioner's decedent, as a stockholder in the Spirella Co. of Great Britain." But in such case neither the petitioner nor the respondent had raised any issue as to whether the tax deducted from dividends by the British corporation represented a tax paid by the shareholder. The respondent allowed the credit probably pursuant to the rulings mentioned above and the petitioner naturally accepted such credit. Hence, the action of the Board in such case approving of such credit is in reality nothing more than a tacit approval of the Commissioner's action in the absence of any controversy. Further, the affirmance of the Board's decision (50 Fed. [2d] 1083) was without opinion and therefore decisive only of the question at issue below.

It is most significant that following the decision of the court below in this case, and ever since December, 1933, the Commissioner and the Bureau have consistently denied a deduction or credit to the shareholder. It is also very significant that the Commissioner before the Board has vigorously defended the shareholders' cases mentioned at the outset on the very grounds contended for by this appellee—namely, that the shareholder did not pay a United Kingdom income tax on his dividend and that the United Kingdom income tax on the company's profits was imposed upon or paid by the company which is entitled to the tax deduction.

Therefore, it is respectfully submitted that there are no rulings or decisions on this issue controlling on this Court and that the only decision on this question is that by the court below in favor of the appellee.

CONCLUSION.

In conclusion, it is respectfully asserted that the United Kingdom income tax, to the extent attributable to income from sources within the United States, is an allowable deduction as a tax imposed upon and paid by the appellee and that no part of such tax was imposed upon and paid by the appellee's shareholders.

Respectfully submitted,

WILLIAM H. HOTCHKISS,
JOHN S. BRECKINRIDGE,
Amici Curiae.

APPENDIX.

United States Revenue Act of 1921:

Sec. 234. (a) That in computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:

*   *   *   *   *   *   *

(3) Taxes paid or accrued within the taxable year except (a) income, war-profits, and excess-profits taxes imposed by the authority of the United States, (b) so much of the income, war-profits and excess-profits taxes imposed by the authority of any foreign country or possession of the United States as is allowed as a credit under section 238, * * *.

*   *   *   *   *   *   *

(b) In the case of a foreign corporation * * * the deductions allowed in subdivision (a) shall be allowed only if and to the extent that they are connected with income from sources within the United States; and the proper apportionment and allocation of the deductions with respect to sources within and without the United States shall be determined as provided in section 217 under rules and regulations prescribed by the Commissioner with the approval of the Secretary.

*   *   *   *   *   *   *

Sec. 238. (a) That in the case of a domestic corporation the tax imposed by this title, plus the war-profits and excess-profits taxes, if any, shall be credited with the amount of any income, war-profits, and excess-profits taxes paid during the same taxable year to any foreign country, or to any possession of the United States: *Provided,* That the amount of credit taken under this subdivision shall in no case exceed the same proportion of the taxes, against which such credit is taken, which the taxpayer's net income (computed without deduction for any income, war-profits, and excess-profits taxes imposed by any foreign country or possession of the United States) from sources without the United States bears to its entire net income (computed without such deduction) for the same taxable year.

British Income Tax Act of 1918:

33.—(1) Where an assurance company carrying on life assurance business, or any company whose business consists mainly in the making of investments, and the principal part of whose income is derived therefrom, or any savings bank or other bank for savings, claims and proves to the satisfaction of the special commissioners that, for any year of assessment, it has been charged to tax by deduction or otherwise, and has not been charged in respect of its profits in accordance with the rules applicable to Case I. of Schedule D, the company or bank shall be entitled to repayment of so much of the tax paid by it as is equal to the amount of the tax on any sums disbursed as expenses of management (including commissions) for that year: * * *

106.—(1) The chamberlain or other officer acting as treasurer, auditor or receiver for the time being of any body of persons chargeable to tax, shall be answerable for doing all such acts as are required to be done under this Act, for the purpose of the assessment of such body and for payment of the tax, and for the purpose of the assessment of the officers and persons in the employment of such body:

Provided that, in the case of a company, the person so answerable shall be the secretary of the company or other officer (by whatever name called) performing the duties of secretary.

(2) Every such officer as aforesaid may from time to time retain out of any money coming into his hands, on behalf of the body, so much thereof as is sufficient to pay the tax charged upon the body, and shall be indemnified for all such payments made in pursuance of this Act.

* * * * * * *

169.—(1) Any tax charged under the provisions of this Act may be sued for and recovered, with full costs of suit, from the person charged therewith in the High Court as a debt due to the Crown, or by any other means whereby any debt of record or otherwise due to the Crown can, or may at any time, be sued for and recovered, as well as by the summary means specially provided by this Act for levying the tax.

(2) Any tax assessed and charged quarterly under the provisions of this Act in respect of weekly wage-earners shall, without prejudice to any other method of recovery under this Act, be also recoverable summarily as a civil debt.

* * * * * * *

237. In this Act, unless the context otherwise requires:

* * * * * * *

"'Body of persons' means any body politic, corporate, or collegiate, and any company, fraternity, fellowship and society of persons, whether corporate or not corporate;"

* * * * * * *

General Rules, British Income Tax Act, 1918:

1. Every body of persons shall be chargeable to tax in like manner as any person is chargeable under the provisions of this Act.

* * * * * * *

19.—(1) Where any yearly interest of money, annuity, or any other annual payment (whether payable within or out of the United Kingdom, either as a charge on any property of the person paying the same by virtue of any deed or will or otherwise, or as a reservation thereout, or as a personal debt or obligation by virtue of any contract, or whether payable half-yearly or at any shorter or more distant periods), is payable wholly out of profits or gains brought into charge to tax, no assessment shall be made upon the person entitled to such interest, annuity, or annual payment, but the whole of those profits or gains shall be assessed and charged with tax on the person liable to the interest, annuity, or annual payment, without distinguishing the same, and the person liable to make such payment, whether out of the profits or gains charged with tax or out of any annual payment liable to deduction, or from which a deduction has been made, shall be entitled, on making such payment, to deduct and retain thereout a sum representing the amount of the tax thereon at the rate or rates of tax in force during the period through which the said payment was accruing due.

The person to whom such payment is made shall allow such deduction upon the receipt of the residue of the same. and the person making such deduction shall be acquitted and discharged of so much money as is represented by the deduction, as if that sum had been actually paid.

(2) Where any royalty, or other sum, is paid in respect of the user of a patent, wholly out of profits or gains brought into charge to tax, the person paying the royalty or sum shall be entitled, on making the payment, to deduct and retain thereout a sum representing the amount of the tax thereon at the rate or rates of tax in force during the period through which the royalty or sum was accruing due.

* * * * * * *

20. The profits or gains to be charged on any body of persons shall be computed in accordance with the provisions of this Act on the full amount of the same before any dividend thereof is made in respect of any share, right or title thereto, and the body of persons paying such dividend shall be entitled to deduct the tax appropriate thereto.

* * * * * * *

21.—(1) Upon payment of any interest of money, annuity, or other annual payment charged with tax under Schedule D, or of any royalty or other sum paid in respect of the user of a patent, not payable, or not wholly payable, out of profits or gains brought into charge, the person by or through whom any such payment is made shall deduct thereout a sum representing the amount of the tax thereon at the rate of tax in force at the time of payment.

(2) Any such person shall forthwith render an account to the Commissioners of Inland Revenue of the amount so deducted, or of the amount deducted out of so much of the interest, annuity, annual payment, royalty, or other sum respectively, as is not paid out of profits or gains brought into charge, as the case may be, and every such amount shall be a debt from him to the Crown and shall be recoverable as such; and the provisions contained in section two of the Stamp Duties Management Act, 1891, in relation to money in the hands of any person for stamp duty, shall apply to money deducted by any such person in respect of tax.

Finance Act of 1920:

27.—(1) If any person who has paid, by deduction or otherwise, or is liable to pay, United Kingdom income tax for any year of assessment on any part of his income proves to the satisfaction of the Special Commissioners that he has paid Dominion income tax for that year in respect of the same part of his income, he shall be entitled to relief from United Kingdom income tax paid or payable by him on that part of his income at a rate thereon to be determined as follows:—

*   *   *   *   *   *   *

Finance Act of 1930:

12.—(3) Where on payment of a dividend (not being a preference dividend within the meaning of this section), income tax has under Rule 20 of the General Rules, been deducted therefrom by reference to a standard rate of tax greater or less than the standard rate for the year in which the dividend became due, the net amount received shall, for all the purposes of the Income Tax Acts, be deemed to represent income of such an amount as would, after deduction of tax by reference to the standard rate last-mentioned, be equal to the net amount received, and for the said purposes there shall in respect of that income be deemed to have been paid by deduction tax of such an amount as is equal to the amount of tax on that income computed by reference to the standard rate last-mentioned.